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Memorandum for:

The Honorable Lawrence Eagleburger
Under Secretary for Political Affairs,
7th Fl, State

Subject: Western Europe and Post-Tito Yugoslavia

Attached, for your information, is a typescript memorandum on West European policies toward Yugoslavia. It examines West European views of Belgrade's political and economic prospects as well as West European efforts to bolster the Yugoslav regime. Please let us know if we may be of further help.



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Attachment:
As stated



12 July 1983

Director,

E U R A

Office of European Analysis

Identical Note sent to all external recipients

EUR M 83-10/93

SUBJECT: Western Europe and Post-Tito Yugoslavia

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Central Intelligence Agency



Washington, D. C. 20505

DIRECTORATE OF INTELLIGENCE

8 July 1983

Western Europe and Post-Tito Yugoslavia

Summary

While expressing concern about Yugoslavia's long-run domestic stability and nonaligned foreign policy, West European governments see little danger to the country in the near term. Reflecting this assessment, they have formed no comprehensive strategy for dealing with Belgrade and tend--both in bilateral relations and in the EC context--to react in ad hoc fashion to developments there. Along with domestic budget problems, their somewhat sanguine view of Yugoslavia's political fortunes also explains the hardnosed attitude of the West Europeans toward Belgrade's financial problems--including a likely refusal to go along with another financial bailout in 1984. [redacted]

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A review of several NATO documents, as well as numerous discussions with West European officials, indicates that the West Europeans--correctly, in our view--do not discern any shift

This memorandum was prepared by [redacted] the Office of European Analysis. It was coordinated with the Office of Soviet Analysis and the Office of Global Issues. Research was completed on 7 July 1983. Questions and comments may be addressed to the Chief of the European Issues Division [redacted]

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in Yugoslav foreign policy under the post-Tito collective leadership and do not foresee any reinterpretation of the Yugoslav version of nonalignment. The West Germans and British argue that Moscow hesitates to push Belgrade too far, and they and other European governments clearly seem to believe that Moscow has no plans to reintegrate Yugoslavia into the eastern bloc. []

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While sanguine about Soviet intentions, the West Europeans are more fearful of threats to Yugoslavia from economically or ethnically inspired domestic instability. They are promoting bilateral consultations to demonstrate support for the Belgrade regime, but face irritants involving trade, emigres, and national minorities. In the multilateral context, the West Germans only grudgingly agreed this year to US urgings that they assume the lead in putting together a financial aid package to prevent rescheduling of Belgrade's foreign debts, crossing their fingers that this and a 1980 preferential trade agreement would help turn the economy around. []

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If Yugoslavia's financial difficulties continue unabated into 1984, as seems likely to us, we believe that virtually all West European governments and private banks will urge a formal debt rescheduling. The four major West European governments, which each face budget deficits and demands for higher domestic spending, will be adverse to increasing aid. In our judgment, only unforeseen political upheaval in Yugoslavia, the emergence of manifest Soviet designs on Yugoslavia, or strong pressure from the United States will induce them to agree to a bailout. And the first two scenarios by themselves will almost certainly induce commercial banks to refuse new loans. []

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West European Views of Yugoslavia

West European governments have long held a major stake in Yugoslavia's political stability and in its version of international nonalignment since Yugoslavia acts as a buffer that denies the Soviet Union ready access to the Adriatic and Eastern Mediterranean. Western Europe also benefits from Yugoslavia's

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role as a counter to pro-Soviet forces in the nonaligned movement. At the time of Tito's death in May 1980, the four major West European governments--the United Kingdom, France, West Germany, and Italy--expressed to US officials concern about the fragility of Belgrade's new collective leadership. According to a US Embassy official in Belgrade, most West European diplomats in Yugoslavia believed that the system bequeathed by Tito was based on political realities, but defied economic rationality and impeded sound economic planning. [REDACTED]

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In view of their misgivings, the West Europeans were undoubtedly somewhat relieved at the smooth transition after Tito's death. West German delegates to NATO's Expert Working Group on Eastern Europe, for instance, reported in February 1981 that in reducing Yugoslavia's foreign trade and balance of payments deficits, Tito's successors had achieved their initial economic goals. The West German delegates also pointed out that the system of collective leadership was functioning successfully and that the prospects for regime stability were good. [REDACTED]

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This upbeat mood proved transitory as economic difficulties and ethnic tensions appeared and Belgrade's economic ties shifted further toward the East. As early as August 1981, for example, the West German NATO Political Advisers reported that rampant inflation, unemployment, and falling real incomes were severely straining Yugoslavia's social cohesion. The West Germans also noted that the ethnic violence in Kosovo in March and April of that year portended worsening relations among Yugoslavia's republics and nationalities. [REDACTED]

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The West Europeans have not, however, acted as if they are seriously alarmed at the Yugoslav situation. While the Big Four countries and smaller ones such as Greece are generally supportive of the new Yugoslav leaders, they have not undertaken any major new bilateral initiatives toward Belgrade. In the multilateral context, the EC signed a preferential trade agreement with Yugoslavia, and some West European governments this year have grudgingly agreed to US urgings to take the lead in putting together a financial aid package to prevent a formal rescheduling of Belgrade's debts that should be ready for disbursement this summer. [REDACTED]

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Economic and Ethnic Problems. The prevailing West European view--which in our judgment may be too optimistic--seems to be that Yugoslavia will "muddle through" its economic problems without serious political repercussions. [REDACTED]

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[REDACTED] while the economic crisis presents Belgrade with its most serious test since 1948, the leadership remains essentially united. A report on the Yugoslav political situation approved by the European

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Parliament in February concludes that the worsening economy is unlikely to call into question the country's political institutions. This optimism, in our judgment, may reflect satisfaction with the smooth operation last year of the first rotation of party and government positions and with the success of the first post-Tito congress of the League of Yugoslav Communists. [REDACTED]

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Several key West European governments also believe that while Yugoslavia's ethnic tensions pose a serious long-term danger, Belgrade has the situation under control. A report [REDACTED] in March notes that the strong national reaction in Serbia to the Albanian disturbances in Kosovo has intensified fears of Serbian domination on the part of the other nationalities. [REDACTED] ambassador, however, noted in January that security forces have kept a lid on persistent small-scale outbursts of Albanian nationalism in Kosovo. He also stated that nationalist unrest in other areas is minor--a view that conflicts with State Department and CIA reporting. In April, [REDACTED] repression had failed to settle the province's fundamental problems, particularly its lack of republic status and the widespread separatism among its Albanian youth. It added, however, that renewed unrest in Kosovo probably would not result in large-scale violence. [REDACTED]

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Foreign Relations. West European officials have repeatedly told US counterparts their governments detect no shift in Yugoslavia's foreign policy since Tito's death. [redacted]

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[redacted] in February its view that Belgrade was continuing efforts to reunite the nonaligned movement at a position of equidistance between the superpowers, seeking to isolate the pro-Soviet faction led by Cuba, Ethiopia, and Vietnam. In numerous contacts with the United States, officials from all Big Four governments have contended that recent meetings between Belgrade and Moscow--including Soviet Foreign Minister Gromyko's visit to Yugoslavia in April 1982 and Soviet Prime Minister Tikhonov's consultations in Belgrade this March--have in no way weakened Belgrade's independent stance. [redacted]

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The West German and British governments argue that Moscow hesitates to push Belgrade too far--a view the other key West European countries probably share.

- o In January, [redacted] concluded in [redacted] that Moscow has pursued a policy of restraint toward post-Tito Yugoslavia. The Soviets, according to the West Germans, have avoided open confrontation on foreign policy disagreements and refrained from testing the collective leadership's political endurance.

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- o In February, [redacted] argued that the Soviets had not allowed their overtures to Albania and trade differences with Belgrade to become serious obstacles to good political relations with Yugoslavia. [redacted]

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The West Germans--and probably the British, Italians, and French--believe that Moscow has no plans to reintegrate Yugoslavia in the eastern bloc. [redacted]

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[redacted] in January, for instance, concluded that the Kremlin strongly desires stability rather than instability in Yugoslavia. The West Germans state, however, that Moscow has no intention of claiming that the Brezhnev Doctrine applies to Yugoslavia. In Bonn's view, Moscow knows that any military intervention would pose incalculable risks, including new financial burdens, diplomatic setbacks in Europe and the Third World, strong resistance by the Yugoslavs, and possible confrontation with the United States. [redacted]

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High officials in several West European governments are more concerned that internal weaknesses, rather than direct Soviet pressure, could gradually force a shift in Yugoslavia's foreign policy orientation. In May 1982, for instance, Secretary General

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of the Italian Foreign Ministry Malfatti stressed to a US official the weakness of the collective leadership in the face of ethnic tensions, economic problems, and "increasing pressure" from the Soviets. In November 1982, then-British Foreign Secretary Pym asserted to US officials that Yugoslavia's economic instability was beginning to have major political implications.

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Most West European governments, however, voice no alarm about a Yugoslav shift away from its policy of nonalignment. The British ambassador to Belgrade even argued in early 1983 that increased assistance could further tilt Yugoslav foreign policy in favor of the West. The European Parliament's report on Yugoslavia of this February concluded that advocates of a pro-Western policy still retain the upper hand.

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Bilateral Relations

Despite concerns about Yugoslavia's political balance, West European countries, including the Big Four and smaller ones such as Greece, have only halfheartedly sought to broaden their bilateral ties with post-Tito Yugoslavia. The results of this political and economic cooperation--and in the case of Italy and Greece, military cooperation as well--have been modest largely because of frictions over issues such as trade, emigres, guestworkers, and national minorities.

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Table 1

Workers from Yugoslavia, by Country of Employment

<u>Host Country</u>	<u>Number in 1977</u>	<u>Percent</u>	<u>Number in 1981</u>	<u>Percent</u>
Austria	140,000	19.9	130,000	18.7
France	55,000	7.8	58,000	8.4
Netherlands	10,000	1.4	10,000	1.4
West Germany	405,000	57.5	403,000	58.2
Sweden	26,000	3.7	25,000	3.6
Switzerland	34,000	4.8	31,000	4.5
Other European countries	35,000	4.9	36,000	5.2
Total	705,000	100.0	693,000	100.0

Italy. Italy, of the four major West European countries, has the warmest ties with Yugoslavia. Rome's policies reflect a shared border and a mutual interest in Mediterranean stability. In order to bolster the successive Yugoslav regimes, the Italian

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government has consistently played down bilateral disputes over boundaries, trade, and national minorities and is the only major West European country to engage in limited military cooperation with Belgrade. The outstanding example of their bilateral cooperation is the Osimo Treaty of 1975 which definitively settled the contentious Trieste frontier issue, reaffirmed the rights of national minorities, and also led to increased consultations and economic cooperation. [redacted]

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Rome has intensified its diplomatic and military consultations with Yugoslavia since Tito's death. According to press accounts, the Italians pledged continued economic and political support during Yugoslav President Mijatovic's visit to Rome in December 1980. [redacted]

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[redacted] Yugoslavia received the first official foreign visit of the present Italian Army Chief of Staff in November 1981, and the two countries' army staffs have conducted periodic consultations. [redacted]

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[redacted] the Italian Army last year agreed to conduct research and development programs as well as limited information pooling with the Yugoslavs. [redacted]

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In order not to damage the spirit of cooperation, Italy has reacted mildly to recent Yugoslav restrictions on trade and travel. Belgrade's austerity measures last October, which inter alia required cash deposits from all Yugoslavs before crossing borders and restricted private imports, severely curtailed retail commerce in Trieste. Foreign Minister Colombo, however, publicly supported Belgrade's actions, and Italian officials stressed to US counterparts the Yugoslavs' purely economic motives for restricting travel. According to the US Embassy in Rome, during Yugoslav Foreign Minister Mojsov's mid-February talks in Italy, Colombo urged an easing of the measures but denied any serious strains in bilateral relations [redacted]

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West Germany. West Germany's economic importance to Yugoslavia--it is Belgrade's most important trading partner in the West--has helped Bonn to advance Western interests in Belgrade. At the same time, Bonn has used its influence in the EC to prod other Community members to be helpful to the Yugoslavs. According to various press and US Embassy reporting, Foreign Minister Genscher and other West German leaders have offered both economic cooperation and encouragement for Belgrade's independent political course in periodic discussions with the Yugoslavs. At the same time, the West Germans in 1980 successfully urged their EC partners to accelerate negotiations on the EC-Yugoslav Trade and Economic Agreement in order to strengthen Belgrade's links to Western Europe. Earlier this year, West German Foreign Ministry officials supported the United States by stressing to their West European counterparts the necessity of addressing Belgrade's financial crisis. [redacted]

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Overshadowing these positive contacts at times are Belgrade's protests that Bonn tolerates nationalist and anticommunist emigre groups which have committed numerous acts of violence against Yugoslav diplomats and installations. Bonn has established a special bureau to counter terrorist acts among and against Yugoslav nationals in the Federal Republic but is unwilling to curtail non-violent political activity.

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The 640,000 Yugoslav workers and dependents in West Germany, which represent the Federal Republic's second-largest foreign population and well over half of all Yugoslavs employed abroad, are a second source of tension. The difficulty stems from Bonn's refusal, at a time when Yugoslav unemployment is growing and Belgrade needs more foreign exchange, to allow Yugoslav workers to seek other work in West Germany after the expiration of specific contracts.

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France likewise attaches prime importance to Belgrade's independence. As in the case of British-Yugoslav relations, disputes concerning emigres have remained subdued in recent years, and French diplomatic sources state that the socialist-led government in Paris wants to strengthen ties with Yugoslavia. Quai Secretary General Gutmann visited Belgrade last December, and Yugoslav Foreign Minister Mojsov met with Mitterrand and Cheysson in Paris in January 1982. According to the US Embassy in Paris, the French emphasized agreement with the Yugoslavs on most world issues and Cheysson praised Belgrade's independent stance. According to press accounts, Prime Minister Mauroy told a visiting delegation from the Yugoslav Federal Assembly in April

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that France desired closer political and economic ties. Aside from periodic consultations, however, France--like the other major West European countries--has not undertaken any major independent initiatives toward Yugoslavia recently. [redacted]

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Greece. Among the smaller NATO and EC states, neighboring Greece has taken the strongest interest in Yugoslav developments. Reflecting their common interest in Balkan stability, the two governments hold regular consultations at ministerial and higher levels. Like the Italians, moreover, the Greeks consult with the Yugoslavs on military matters as indicated by the exchange of visits by their defense ministers and service chiefs. [redacted]

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Athens and Belgrade agree on most world issues, but ironically the Yugoslavs find some of Greek Socialist Prime Minister Papandreou's views too "progressive." According to the US Embassy in Belgrade, Yugoslav leaders are particularly skeptical of Papandreou's notion of a nuclear-free zone in the Balkans. [redacted]

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The Macedonian question is the only major recurring irritant in Greek-Yugoslav relations. Belgrade views the Yugoslav Macedonian Republic as the homeland of a distinct nationality with kinsmen in both Bulgaria and Greece. Athens vehemently denies the existence of such a minority within its borders and rejects Yugoslavia's occasional protests about alleged maltreatment of Macedonians as interference in Greek internal affairs. Both sides have generally played down the Macedonian question in recent years, but the issue continues to cast a pall over their otherwise close ties. [redacted]

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Multilateral Relations

Although West European governments have done little to strengthen their bilateral ties with Belgrade since Tito's death, they have been more forthcoming when dealing jointly with the Yugoslavs. In particular, Yugoslavia's recent economic problems have elicited coordinated responses by Western Europe. The European Community is attempting to strengthen commercial ties by means of the 1980 preferential trade agreement, while a more informal grouping of Yugoslavia's government and private Western creditors--at US urging--is implementing a package of financial aid. [redacted]

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The 1980 Trade Agreement. The European Community concluded its first preferential trade agreement with Belgrade in April 1980 in order to bolster Yugoslavia's new collective leadership.

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Table 2
Yugoslav Trade with EC-10^a

	<u>1975</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
	(Million US \$)				
Exports	971	1,846	2,368	2,531	2,140
Imports	3,236	4,922	5,257	5,648	4,436

Table 3
Yugoslavia: Trade Balance

	<u>1975</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
	(Million US \$)				
World	-3,624	-6,370	-6,125	-4,889	-3,116
Of which:					
EC ^a	-2,265	-3,076	-2,889	-3,117	-2,295
USSR	206	-392	-209	678	613
Eastern Europe ^b	-178	-396	-229	-166	-68
United States	-151	-679	-622	-573	-435

Table 4
Yugoslavia: Shares of Foreign Trade
(Percent)

	<u>1975</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
<u>Import Shares</u>					
EC ^a	42.0	38.3	34.8	35.7	33.1
USSR	10.5	13.9	17.9	18.8	20.3
Eastern Europe ^b	13.5	12.9	11.4	11.8	13.9
United States	5.4	8.2	6.7	6.1	11.2
<u>Export Shares</u>					
EC ^a	23.8	28.4	26.4	23.2	20.8
USSR	24.9	21.6	27.7	33.3	32.4
Eastern Europe ^b	21.1	19.4	16.5	15.6	17.5
United States	6.5	5.7	4.4	3.5	10.0

^a Includes Greece for entire period.

^b Includes Bulgaria, Czechoslovakia, East Germany, Hungary, Poland and Romania.

The agreement aimed to reduce Yugoslavia's growing trade deficit with the Community, which by 1979 accounted for nearly half of its total deficit on foreign trade. Reporting by the US Mission to the EC indicates that the Community also hoped to increase its share of Yugoslavia's total trade, which had fallen from 43 percent in 1970 to under 35 percent in 1979, and to lessen Belgrade's growing economic dependence on the East. More important than economic aims, in our judgment, was the Community's desire to demonstrate its political support to Belgrade at a time of Yugoslav nervousness over the Soviet invasion of Afghanistan and Tito's impending death. []

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The 1980 Trade and Cooperation Agreement provided limited nonreciprocal concessions on most Yugoslav merchandise exports to Western Europe. The accord assured free access to EC markets for over 70 percent of Yugoslavia's industrial products and reduced quotas and tariffs on a list of so-called sensitive items such as textiles and nonferrous metals. Agricultural sales, Yugoslavia's leading source of export earnings, remain strictly limited. The Community pledged infrastructure loans to Belgrade and non-discrimination in working conditions and social security, though not in employment itself, for the 800,000 Yugoslav guestworkers in Western Europe. []

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Although the trade provisions of the agreement took effect in 1980, foot-dragging by the West German Bundestag prevented formal ratification until February 1983. Yugoslav and West European leaders called the agreement's entry into force a milestone in Yugoslav-EC relations. The EC-Yugoslav Cooperation Council established by the agreement met for the first time in May to discuss joint ventures in science, technology, and industry. In addition, the EC Commission last February brought approximately 600 West European business people to Belgrade for a week of consultations with Yugoslav counterparts. According to an EC publication, the meetings resulted in about fifty cooperation contracts, primarily in the fields of automotive parts and agriculture. []

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Thus far, however, the agreement has generally been unsuccessful in achieving its economic objectives. The trade concessions have failed to reverse the downward trend of EC participation in Yugoslav foreign trade. In 1982, EC shares of Yugoslav exports and imports were significantly lower than in 1979. In the same period, trade with CEMA grew to one-third of Yugoslavia's imports and half of its foreign sales. The Soviet Union increased its share of both Yugoslav exports and imports while East European shares generally held steady. The East European countries have been major purchasers of Yugoslavia's manufactures, which are generally too expensive and too low in quality to compete successfully in West European markets. Higher Soviet oil prices account for much of the dollar increase in Soviet sales to Yugoslavia. []

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While Yugoslavia's trade deficit with Western Europe declined in 1982, this was due largely to lower imports from the Community. The recession in the West and inflation in Yugoslavia held Yugoslav exports to modest levels. In addition, with its accession to the Common Market, Greece has diverted its purchases of beef, traditionally a major Yugoslav export item, from Yugoslavia to Western Europe. []

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The Financial Aid Package. Political motives prompted the West European decision to join in multilateral assistance in lieu of a rescheduling of Yugoslavia's debts. The Yugoslav Government has adamantly rejected a formal debt rescheduling and enacted austerity measures to balance its foreign accounts. According to US Embassy officials, Belgrade feared a rescheduling would advertise the failure of its economic policies and create irresistible domestic pressures for reform. While many officials in the Big Four finance ministries regard rescheduling as inevitable in the longer term, the West European governments have accepted US arguments that Belgrade's present austerity program will achieve economic progress while limiting the political risks to Belgrade's leaders. [redacted]

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On 19 January, Yugoslavia's leading government creditors adopted a package of emergency assistance. A majority of the EC and EFTA member states, along with Canada, Japan, and the United States, pledged a total of \$1.3 billion in credits. The package is part of a broader program that includes an IMF standby arrangement and loans from the Bank for International Settlements and the World Bank. In addition, the program calls for private bankers to roll over maturing credits and to grant further loans, a course that would avoid the necessity for a formal debt rescheduling. [redacted]

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Disagreements between the Western governments and the commercial banks delayed implementation of the assistance package. [redacted] the banks insist that government-guaranteed loans to Yugoslavia be refinanced on the same terms as unguaranteed credits in order to ensure a fair apportionment of risk between governments and private lenders. The governments, however, argue that the January agreement already provides for burdensharing and that altering its terms could unravel the entire assistance effort. [redacted]

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The commercial lenders are unlikely to torpedo the entire assistance effort by rejecting the governments' proposal. [redacted]

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Outlook

We believe that the major West European governments are unlikely to develop a comprehensive joint approach to Yugoslavia. The West Europeans see little cause to change their present policies toward Belgrade because most believe that Yugoslavia can "muddle through" with only limited assistance from the West. The West Europeans probably will continue to take ad hoc policy responses to discrete Yugoslav developments, and probably will continue to look to the United States to assume the lead in formulating Western policy toward Belgrade. [redacted]

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In the near term, the West Europeans probably will continue to focus their attention on Yugoslavia's economic problems. West European governments and private bankers doubt that the assistance package will enable Yugoslavia to solve its financial problems. [redacted]

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[redacted] Yugoslavia will probably continue to require debt relief for several years. [redacted]

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Nonetheless, the major West European governments probably will remain reluctant to increase trade concessions or economic assistance significantly to Yugoslavia next year. All face budget deficits and demands for higher domestic spending. West European foreign ministries, which stress Belgrade's political importance, will continue to work for good relations, but finance and economics ministries will emphasize the domestic costs of economic aid. In addition, we believe that West European governments will continue to urge Belgrade to adopt structural economic changes as a basis for closer commercial and financial ties. [redacted]

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Implications for US Policy. If Yugoslavia's financial problems continue unabated in 1984, the West Europeans, in our judgment, would almost certainly urge a formal debt rescheduling. [redacted] virtually all bankers and government leaders in the major West European countries believe that a rescheduling in 1984 would both ease the burden on Western lenders and give Yugoslavia more time to put its financial house in order. [redacted]

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In our judgment, it would take strong pressure from the United States to induce the West European governments to accept another financial bailout in early 1984. In addition, unforeseen threats to Yugoslavia's political stability--such as major outbreaks of ethnic violence, open feuding among the collective leadership, or increased Soviet meddling--might induce the West European governments to drop their preference for a formal debt rescheduling. But political crises, especially if Yugoslavia appears near insolvency next year, would scarcely incline commercial banks to make new loans. [redacted]

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We believe the West European governments are unlikely to insist publicly on structural reforms, which the Yugoslav authorities would view as threats to their political legitimacy and to Yugoslavia's independence and nonalignment. Western insistence probably will be private, and both governments and banks will almost certainly also insist on Yugoslav fulfillment of IMF performance criteria, including reductions in credit growth and inflation, positive real interest rates, and improvements in the current account. The banks may also demand access to economic data Belgrade provides

to the IMF. Yugoslav leaders probably will resent such increased pressure from West European banks and governments, but Belgrade is unlikely to sever its Western ties as long as Western assistance remains essential to the Yugoslav economy. [REDACTED]

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